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450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
916-323-3135 • FAX 916-323-3387
www.boe.ca.gov

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June 19, 2012

, Esq.

Honorable
County Assessor

***Re: Parent-Child Exclusion and Trust Ownership of Legal Entity Interests Upon Death
Assignment No. 12-032***

Dear Messrs. and :

This letter is in response to your joint correspondence and request for a legal opinion dated December 28, 2011 (December 28 letter). You have asked our opinion as to the change in ownership consequences of a transfer of California real property (the Property) from an irrevocable trust (the Trust) to the children of trustor (Wife), where title to the Property was held by a limited liability company on the date of Wife's death. As explained below, it is our opinion that the transfer does not qualify for the parent-child exclusion because at the time of Wife's death the Trust held ownership interests in a legal entity and not interests in real property.

Facts

Wife and her husband (Husband) owned the Property as tenants in common prior to the formation of the Trust. On October 23, 1991, Husband and Wife formed the Trust and conveyed the Property to the Trust on November 12, 1991. The Trust was revocable until the death of the first trustor, at which time the trust estate divided into Trust A (survivor's trust) and Trust B (decedent's trust). Husband died on July 6, 1995, at which time Wife became the sole present beneficiary of the Trust. On March 3, 2008, Wife and her daughter (Daughter) executed a Certificate of Membership certifying they, as co-trustees of the Trust, were together the owners of a 100 percent membership interest in _____, LLC, a California limited liability company (the LLC).

On April 2, 2008, the co-trustees transferred the Property to the LLC. Section 7.1 of the Operating Agreement of the LLC dated January 14, 2008 (the Operating Agreement) provides, in relevant part:

7.1 Dissolution Event. Upon the occurrence of the death, withdrawal, resignation, retirement, insanity, bankruptcy or dissolution of any Member ("Dissolution Event"), the Company shall dissolve unless all of the remaining Members ("Remaining Members") consent within ninety days of the Dissolution Event to the continuation of the business of the Company.¹

Wife died on December 20, 2009. Trust A merged with Trust B and the Trust assets were to be distributed in equal shares to Husband's and Wife's five children.² We are told that the LLC was formally dissolved on December 14, 2011, and title to the Property was conveyed back to the Trust at that time. Our review of the Secretary of State's website shows the LLC's status as "canceled".

Law and Analysis

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a "change in ownership," unless an exclusion from change in ownership applies. A "change in ownership" is defined as a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equivalent to the value of the fee interest. (Rev. & Tax. Code, § 60.) Revenue and Taxation Code³ section 63.1, which implements the parent-child and grandparent-grandchild exclusions, excludes from change in ownership the transfer between parents and children of any number of principal residences and the first \$1 million of full cash value of other real property. (Rev. & Tax. Code, § 63.1, subds. (a)(1) and (2).) "Real property" does not include any interest in a legal entity. (Rev. & Tax. Code, § 63.1, subd. (c)(8).)

It is well established that trusts are not considered separate entities for California property tax change in ownership purposes, and therefore we determine who has the present beneficial ownership interest in the trust corpus by disregarding the trustee's legal title. This is referred to as "looking through a trust." Under this principle, the owner of the present beneficial interest in the trust corpus is the trustor under a revocable trust and the present beneficiary under an irrevocable trust. (Rev. & Tax. Code, § 62, subd. (d); Property Tax Rule 462.160, subd. (b)(2)⁴; *Reilly v. City and County of San Francisco* (2006) 142 Cal.App.4th 480.)

Consistent with this principle, a change in ownership does not occur when a trustor transfers real property or an ownership interest in a legal entity to a trust that is revocable by the trustor because the trustor is still considered the owner of the transferred interests. (Rev. & Tax. Code, § 62, subd. (d); Property Tax Rule 462.160, subd. (b)(2).) However, a change in ownership of real property does occur at the time that a revocable trust becomes irrevocable

¹ See page six of the Operating Agreement. (Note that we were provided only with page six of the Operating Agreement containing the language of Section 7.1.)

² See Trust document, pp. 18-19.

³ All section references are to the Revenue and Taxation Code unless otherwise specified.

⁴ Cal. Code Regs., tit. 18, § 462.160, subd. (b)(2). All subsequent references to Rules are to sections of title 18 of the California Code of Regulations.

unless the trustor is the present beneficiary of the trust, or the transfer from the trustor to the present beneficiary would otherwise be excluded from change in ownership. (Rev. & Tax. Code, § 61, subd. (h); Rule 462.160, subds. (b)(1) and (b)(2), and Example 3.) In addition, the transfer of an ownership interest in a legal entity holding an interest in real property into a trust in which the trustor-transferor is the sole present beneficiary is not a change in ownership. (Rule 462.160, subd. (b)(1)(C).)

Section 61, subdivision (j) provides that, as a general rule, the transfer of any interest in real property to or from a legal entity is a change in ownership and results in reappraisal of the property interest transferred.

Section 62, subdivision (a)(2) provides an exclusion from change in ownership under section 61, subdivision (j), for proportional ownership interest transfers of real property between a legal entity and an individual. To qualify for the exclusion, such transfers must result solely in a change in the method of holding title to the real property, and the proportional ownership interests of the transferors and transferees in each and every piece of real property transferred must remain exactly the same both before and after the transfer. (Rev. & Tax. Code, § 62, subd. (a)(2); Rule 462.180, subd. (b)(2).)

Section 64, subdivision (a) provides the general rule that the transfer of ownership interests in a legal entity, such as limited liability company membership interests, does not constitute a transfer of the real property owned by the legal entity. One exception to this rule is found in section 64, subdivision (d), which provides that when a transfer of real property is excluded from change in ownership under section 62, subdivision (a)(2), the holders of the legal entity interests immediately after the excluded transfer become "original co-owners" for purposes of determining the change in ownership consequences of any subsequent transfers of those legal entity interests. Then, section 64, subdivision (d) provides that when ownership interests representing cumulatively more than 50 percent of the total interests in the legal entity are transferred by any of the original co-owners in one or more transactions, a change in ownership of that real property owned by the legal entity that was previously excluded from change in ownership under section 62, subdivision (a)(2) occurs.

Rule 462.260, subdivision (d) provides that the date of change in ownership of property held in a revocable trust is the date the trust becomes irrevocable. This same rule applies whether the property held in the trust is real property or ownership interests of a legal entity that held real property. Example 1 in Rule 462.260 states, "A creates an inter vivos revocable trust that becomes irrevocable upon A's death. The date of change in ownership is the date of A's death."

As stated above, on April 2, 2008, Wife and Daughter, as co-trustees of the Trust, transferred title to the Property to the LLC. Because Wife was the sole present beneficiary of the Trust at that time, this transfer was a transfer between an individual and a legal entity and resulted in a change in ownership under section 61, subdivision (j). However, this transfer was excluded from change in ownership under section 62, subdivision (a)(2) because the Trust continued to have the same present beneficiary, Wife. That is, both before and after the transfer, Wife held a 100 percent ownership interest in the Property, whether she owned that beneficial interest as the sole present beneficiary of the Trust or as the sole present beneficiary of the Trust which owned 100 percent of the LLC membership interests. Thus, under section 62, subdivision (a)(2), there was no change in ownership as a result of the transfer of the Property to the LLC.

However, as a result of the application of the exclusion from change in ownership under section 62, subdivision (a)(2), Wife, as sole beneficiary of the Trust, became an original co-owner with respect to the LLC membership interests under section 64, subdivision (d).

On December 20, 2009, Wife died and her children immediately became the present beneficiaries of the Trust. Under Rule 462.260, the date of change in ownership is the date of death. The beneficiaries claim the parent-child exclusion under 63.1 applies to this change in ownership. Because the parent-child exclusion applies only to transfers of real property and does not apply to transfers of legal entity interests, the issue here is whether the Trust owned real property interests or LLC membership interests at the time of Wife's death.

Mr. Rubens states that the LLC's Operating Agreement provides that the company shall dissolve on Wife's death, referencing page six of the Operating Agreement. (December 28 letter, p. 2.) He argues that since the LLC dissolved immediately at Wife's death, the Trust held real property and not legal entity interests at the time of distribution of the Property. First, we disagree that Wife's death caused the LLC to dissolve because, in our opinion, Wife was not a "Member" of the LLC.⁵ In California, the identity of a limited liability company's members is a matter governed by the provisions of the Corporations Code and its operating agreement. The principles set forth above that govern the determination of the owner of real property and legal entity interests for property tax change in ownership purposes are not applicable when determining the members of a limited liability company for general corporate law purposes. Although we "look through a trust" to determine the present beneficial ownership of real property for property tax change in ownership purposes, we do *not* "look through a trust" to identify the members of a limited liability company for general corporate law purposes. Instead, when a trust (through its trustee) holds legal title to legal entity ownership interests such as corporate stock, partnership interests, or limited liability company membership interests, we treat the *trust itself* as the shareholder, partner, or limited liability company member for general corporate law purposes. (See, e.g., Prob. Code, § 16220 et seq.; Corp. Code, §§ 605, subs. (a)(2), (a)(3); Corp. Code §§ 15903.01, 15904.01, 16101, subd. (13); 17001, subs. (x) and (ae).) We know of no authority for "looking through the trust" to the trust's present *beneficiary* as the owner of the legal entity interests for purposes of the Corporations Code.⁶ Therefore, in this case, the Trust was the sole member of the LLC at Wife's death. As a result, in our opinion, Wife's death did not trigger a *dissolution* of the LLC under Section 7.1 of the Operating Agreement. For that reason, in our opinion the Trust clearly held the LLC interests upon Wife's death.

However, *even if* the LLC were to have dissolved upon Wife's death our answer is the same. In California, a limited liability company's membership, dissolution, winding up, continuing existence for winding up purposes, cancellation, and ability to continue in existence even after a dissolution are all matters governed by the provisions of the Corporations Code and not by the property tax laws. Some of these matters may be addressed in the company's articles

⁵ Section 7.1 of the Operating Agreement, on page six and set forth fully above, provides the LLC shall dissolve upon the death of a "Member". Because we have not been provided with the entire Operating Agreement, we are not aware of how the term "Member" is defined, and whether it expressly includes Wife. We assume, however, that "Member" is defined as referring to an *actual member* of the LLC as determined under California law and does not expressly include Wife in the definition.

⁶ We note that one recent court case concluded that a trustee was the owner of legal entity interests for corporate law purposes, however property tax change in ownership issues were not under consideration in that case. (See *Presta v. Tepper* (2009) 179 Cal.App.4th 909.)

of organization or in its operating agreement, while others are expressly governed by the Corporations Code.

Events triggering the dissolution of a limited liability company are clearly stated in Corporations Code section 17350. This section states that a limited liability company shall be dissolved and its affairs shall be wound up upon the happening of the first of several events, one of which is at the time specified in its operating agreement.

Corporations Code section 17352, subdivision (a) provides that in the event of a dissolution of a limited liability company, the members may wind up the company's affairs and must give written notice of the commencement of the winding up by mail to all known creditors and claimants whose addresses appear on the company's records. Under Corporations Code section 17353, subdivision (a), except as otherwise provided in the company's articles or operating agreement, after determining that all of the company's known debts and liabilities in the process of winding up have been paid or adequately provided for, the remaining assets must be distributed among the members according to their respective rights and preferences as set forth in that subdivision.

Corporations Code section 17354 addresses the existence of a limited liability company after dissolution and during the winding up period. It provides that:

- (a) *A limited liability company that is dissolved nevertheless continues to exist for the purpose of winding up its affairs*, prosecuting and defending actions by or against it in order to collect and discharge obligations, *disposing of and conveying its property*, and collecting and dividing its assets. A limited liability company shall not continue business except so far as necessary for the winding up thereof. (Emphasis added.)
- (b) No action or proceeding to which a limited liability company is a party abates by the dissolution of the limited liability company or by reason of proceedings for the winding up and dissolution thereof.
- (c) Any assets inadvertently or otherwise omitted from the winding up continue in the dissolved limited liability company for the benefit of the persons entitled thereto upon dissolution and on realization shall be distributed accordingly.

Corporations Code section 17356, subdivision (a)(1) provides that, upon the dissolution of a limited liability company, the managers must file with the Secretary of State a certificate of dissolution. Upon the completion of the winding up of the affairs of the limited liability company, the managers must file a certificate of cancellation of the articles of organization. (Corp. Code, § 17356, subd. (b)(1).) Notwithstanding that a certificate of dissolution has been filed, a majority in interest of the members can vote to continue operation of a limited liability company after the event that triggered a dissolution, thereby nullifying the dissolution, by filing a certificate of continuation, under certain circumstances. (Corp. Code, § 17357.)

Therefore, even though an event may have *triggered dissolution* of a limited liability company, the Corporations Code clearly sets up a scheme where the dissolution is but the first step in a process that may or may not lead to the end of the company's separate legal existence.

Corporations Code section 17354 unequivocally states that the company *continues in existence* after dissolution for purposes of winding up and disposing of and conveying its property. (See *Kwok v. Transnation Title Insurance Company* (2009) 170 Cal.App.4th 1562.) Corporations Code sections 17352 and 17353 detail how such winding up must be conducted and how, when and to whom its property may be conveyed. It is only after the winding up of the affairs of the company has been completed and the certificate of cancellation has been filed with the Secretary of State that a limited liability company ceases to exist as a separate legal entity.⁷

In this case, even if the LLC dissolved at Wife's death, the LLC continued to exist after the date of Wife's death and throughout its winding up period until, presumably, the filing of a certificate of cancellation of the articles of organization with the Secretary of State upon the *completion* of the winding up of the affairs of the LLC. (Corp. Code, §17356, subd. (c)). When a trust holds legal entity interests and that entity owns real property, the dissolution of the legal entity does not mean that the trust immediately obtains ownership of the entity's real property for change in ownership purposes. For change in ownership purposes, if the trust owns legal entity interests at the date of death of the trustor, even if that death causes a dissolution of the entity, the legal entity interests and *not* the real property owned by the legal entity, transfer to the beneficiaries. Here, the LLC must actually transfer the real property to the Trust in liquidation and in accordance with the Corporations Code. As such, the transfer on the date of Wife's death to the remainder beneficiaries that occurred for property tax purposes was of the LLC membership interests held by the Trust, and not the Property. Because section 63.1, subdivision (c)(8) says that the parent-child exclusion does not apply to transfers of legal entity interests, that exclusion is unavailable. Therefore, at Wife's death, 100 percent of the original co-owner interests in the LLC transferred to the beneficiaries, resulting in a change in ownership of the Property under section 64, subdivision (d), because legal entity ownership interests representing cumulatively more than 50 percent of the total interests in the legal entity were transferred by the original co-owners. Therefore, the Property must be reassessed as of the date of Wife's death. Furthermore, sections 480.2 and 482 in effect at the time of Wife's death in December 2009 required the filing of a change in ownership statement with the Board's Legal Entity Ownership Program in Sacramento since there was a change in ownership of the LLC under section 64, subdivision (d).⁸

Mr. [redacted] cites Property Tax Annotation⁹ (Annotation) 625.0156 (May 16, 2007) as authority for the assertion that real property interests transferred to the children at Wife's death. In the backup letter to that annotation, which dealt with the dissolution of a general partnership the interests of which were held in trust, we stated that Corporations Code section 16801 governed the dissolution of general partnerships and provided that 90 days after the dissociation by death of a partner, the partnership dissolves "and its business is wound up," inferring that the winding up was automatically completed on the same day. Thus, we concluded that at the 90-day mark after death, the trust automatically became the owner of the real property previously owned by the partnership. To the extent that letter can be read to state that the partnership dissolves and winds up by operation of law on the same day – thereby distributing its property automatically to the trust estate before distribution to the beneficiaries – it is incorrect.

⁷ For similar provisions on limited partnerships, see Corp. Code, §§15908.01-15908.09, and for general partnerships, see Corp. Code, §§16100-16114.

⁸ Information about filing requirements is available at boe.ca.gov/proptaxes/leop.htm.

⁹ Property Tax Annotations are summaries of the conclusions reached in selected legal rulings of Board legal counsel published in the Board's Property Tax Law Guide and on the Board's website. See Cal. Code Regs., tit. 18, § 5700 for more information regarding annotations.

Instead, at the 90-day mark after the dissociation by death of one of the partners, under Corporations Code section 16801, subdivision (2)(A), the partnership dissolved and the winding up process *began*. The termination of the partnership would occur upon *completion* of the winding up process, all in accordance with Corporations Code section 16802 et seq. During the winding up period, the trust would have obtained the partnership's real property interests in accordance with the requirements under Corporations Code section 16807 governing the liquidation of the partnership's assets. Our analysis in the backup letter misstated when the winding up would be completed in that case. We have requested that that annotation be deleted to avoid confusion and that it be replaced with an annotation and this opinion letter as guidance on this issue.

Finally, we express no opinion on the valuation of the Property. Those issues are best addressed with the assessor or in an appeal with the local assessment appeals board.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on present law and the facts set forth in your letter, and are not binding on any person or public entity.

Sincerely,

/s/ Susan Galbraith

Susan Galbraith
Tax Counsel

SG:mcb

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cc: _____, Esq.
County Counsel

Mr. David Gau	MIC:63
Mr. Dean Kinnee	MIC:64
Mr. Todd Gilman	MIC:70